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Good afternoon, and thank you for that nice introduction. I was pleased to be offered the opportunity to discuss DOT's views on airline competition, with a focus on our forthcoming study of airport practices and how they affect airline competition. Now, I know the title of this session is "Airline Competition/Airport Business Practices – An Inquiry in Search of a Problem," and I don't want to prejudge the results of a study that is still being written, but at your next conference you may want to consider organizing a session on "Airline Competition/Airport Business Practices – Are Federal, State and Local Officials Doing Enough to Promote Airline Competition and Competitive Access at Airports?"

There is, as we all recognize, a vigorous, ongoing public policy debate about aviation issues, including the issue of airline competition. The fundamental nature of the debate has not changed, however: Most Members of Congress continue to agree that airline deregulation, despite a few rough spots along the way, has been enormously beneficial for the American public. Policy makers, in short, want to make the current system work better, not to reregulate the airline industry.

At DOT, we believe the best way to preserve the benefits of airline deregulation is to create an environment that provides all air carriers with a fair chance to compete and prosper. Note that I said “fair chance.” No one at DOT is proposing to insulate new entrants or smaller airlines from competition or to unfairly handicap established air carriers.

Competition, of course, can take many forms. But it’s pretty clear that an airline attempting to enter a market cannot compete successfully if it does not have access to essential airport facilities and services on reasonable terms. Even in the best of circumstances, entering a new market is tough. But, unfortunately, even when new entrant airlines have been prepared to incur the substantial cost of entering a market, they have, in some cases, been unable to gain competitive access to an airport’s facilities – that is, gates, baggage-handling areas, maintenance facilities, ticket counters, and passenger waiting areas. Some new entrant and smaller air carriers have complained -- to Congress, GAO, and DOT -- about the problems they have encountered when they attempted to serve certain large hub airports in the Midwest and the East.

To gather information on airport business practices and how they affect airline competition, last year Secretary Slater announced the formation of a joint OST-FAA Task Force to study two broad questions: Are airport practices at specific airports preventing new entry or making it more difficult for incumbent airlines to compete against each other? And have Passenger Facility Charges been used in ways that have encouraged air carriers to compete?

We recognize that the airport business practices in effect today may have been established decades ago in response to specific economic, financial, or political factors. We are interested in understanding whether the same factors and circumstances that shaped airport business practices in the past are still important in today's competitive environment. We are also curious to know if airport managers consider the benefits to their communities of vigorous airline competition. What actions have they taken to encourage competition? Do airports, in effect, have a program in place to promote airline competition? Should airports take aggressive action to encourage new airline entry, even if it means changing established business practices? Or is it more appropriate for airports to take no role in determining whether air carriers serve their communities?

A key objective of our study is to understand whether today's airport business practices increase entry barriers at airports. To address the issue of airport practices and how they influence entry barriers and airline competition, we have gathered information from various sources, including interviews with airport executives. We also recognized that we would need to study business practices and competitive conditions at certain large airports. Every airport executive we interviewed was generous with his or her time and extremely helpful in guiding us through the intricacies of airport operations and business practices. On behalf of the Department, I would like to say thank you. We chose to study 13 airports.¹ These airports were selected because of their importance to the national aviation system or because they offered a unique opportunity to study how airport practices influence competition among air carriers.

We also worked closely with Airports Council International – North America, which developed and tested a questionnaire on airport capacity, operations, and practices. The questionnaire was sent by

¹ The airports are located in the following communities: Charlotte, Baltimore, Dallas, Cincinnati, Pittsburgh, Salt Lake City, Phoenix, San Jose, Houston, Denver, Minneapolis, Detroit, and Atlanta.

ACI to its members. The ACI survey will provide the aviation community and public officials a wealth of information about industry trends and competitive conditions at airports. The data obtained from the questionnaire will improve our understanding of airport practices and play a major role in our study.

Based on what we have learned so far, let me take a few minutes to pose a series of questions. Please think carefully as to how you would answer these questions. In my view -- and these are only my views -- how they are answered will have a direct bearing on whether current airport practices are viewed by policy makers as adversely affecting airline competition, particularly at concentrated hub airports.

As we all know, even if new entrant carriers have access to airport facilities and services on reasonable terms, many will not succeed in the marketplace. However, to provide competitive service at an airport, particularly a concentrated hub airport, is it enough for an airport to provide “non-discriminatory access” to an entrant or should an airport also be required to provide “competitive access”? Is there a difference? Based on my observations and discussions with airline and airport officials, I would say yes.

In comments to our public docket, airport after airport stated that no new airline had ever been denied access. Small airlines, on the other hand, say reasonable access at many large airports is very problematic. But, again, is there a difference between “access” and “competitive access”?

For example, if a new entrant were provided competitive access at an airport, would it have to sublease gates and other facilities from an incumbent carrier, which could be the dominant carrier? Or would the entrant be offered a more flexible arrangement? Would the entrant find a clearly stated policy as to how it could obtain gates and other facilities and how, if it succeeds in the marketplace, it can expand at the airport? Are airport officials managing their assets in ways to advance competition? Do airport managers, especially at gate-constrained airports, know how frequently their gates are being used? Do they track gate utilization trends? Do they know whether more efficient gate usage would allow more entry, would allow incumbent carriers to grow faster, or would permit new entrant air carriers to grow with less disruption to their flight operations? Should airport officials make decisions regarding gate-leasing arrangements based on “filling out their existing service patterns,” “competitive service,” or “new or

expanded service”? These are the questions we – and I mean airline, airport, and public officials -- have to answer.

Airport managers generally desire greater control over gates and other facilities at their airports. But, as we know, many airports have entered into long-term, exclusive use contractual relationships with their airline tenants.² These agreements restrict the ability of airport officials to reallocate gates or to adopt other policies that would make it easier for air carriers to begin operating at these airports. Over time, airport managers may gain more control over their facilities, and thus be in a better position to promote new air service. But these contractual relationships often last a long time. Gate lease agreements at several large hub airports have years to run before they can be renegotiated, even if officials at these airports were inclined to modify them or to adopt other policies to encourage entry.

Some airport officials, to be frank, are more comfortable adopting a “let-the-carriers-work-it-out” approach to new entry at their airports than they are serving as “ombudsmen for competition.” There is, in

² Exclusive use leases are generally considered long-term arrangements coinciding with the term of a corresponding tax-exempt airport revenue bond. An exclusive-use lease grants a carrier sole access to and the right to use a gate (or gate-related facility such as passenger hold rooms, passenger ticketing positions, and baggage claim devices) for the duration of the lease and, as a rule, does not require the airline tenant to share its space.

short, a difference in management philosophy among airport officials as to how actively they should encourage air carriers to operate at their airports. And there is a difference in philosophy as to what actions they should take to make new entry a reality.

Permit me to state an obvious but important truth: A commitment on the part of airport managers to promoting competition at their airports is critical to the success or failure of new entrant air carriers. To ensure that all air carriers that want to serve an airport have full, competitive access to all gates, facilities, and ancillary services on reasonable terms, airport officials must use all of the policy tools at their disposal.

More competition at an airport can generate enormous benefits for an entire region, far beyond the local community. Since the mid-1990s, airline passengers in the Washington-Baltimore metropolitan region – indeed, the Mid-Atlantic States -- have enjoyed the benefits of lower airfares and more service. While officials at Baltimore/Washington International Airport never made a strategic decision to “market” the airport as a regional center for low-fare air service, this is in fact the case today. Like other airports, BWI has a marketing program in place to entice airlines to serve the airport. For a period of approximately ten years, BWI officials worked to

entice Southwest Airlines to serve BWI. In the words of a senior BWI executive, "The inauguration of air service by Southwest Airlines to the greater Washington/Baltimore region in 1994 was the most significant event in BWI's history concerning enhancing competition among air carriers."³

Many economic, financial, and competitive factors influenced Southwest's decision to serve BWI. But the business practices in place at BWI, including the imposition of PFCs to construct and refurbish gates over the opposition of some incumbent air carriers, and the dedicated efforts made by BWI's management to meet Southwest's request for gates and other facilities, were also important factors in Southwest's decision to serve BWI. Moreover, because BWI officials closely monitor gate-utilization, have adopted preferential use gate leases, and have chosen to retain control over several gates, the requests of other new entrant carriers, including USAirways' Metrojet, Pro Air, America West, and Frontier, to serve BWI have also been met.⁴

³ Nicholas J. Schaus, Airports Council International – North America, *Airport Gate Availability/PFC Survey*, September 1998.

⁴ Shared- or preferential-use gate lease arrangements generally give the tenant airline the primary right to use the facility and, under "use-it-or-share-it" provisions, require the primary tenant to permit a requesting airline to use the facility if underutilized. Some preferential-use leases give the primary tenant the right to charge the secondary tenant for facility usage. Some leases allow "bumping" rights by the primary tenant in the event it increases its operations. Some airports retain the right to recapture the facilities and reallocate excess capacity, under use-it-or-lose-it provisions.

These policies have resulted in significant benefits for consumers. According to recent GAO study, between 1990 and 1998 average airfares adjusted for inflation declined significantly in markets served from BWI. Specifically, average airfares declined 49 percent, 35 percent, and 38 percent in short-haul, medium-haul, and long-haul markets.⁵ (The average decline across markets was 40 percent.) Because air carriers serving Dulles International and Reagan National had to lower their airfares in certain markets in response to the pricing policies of air carriers at BWI, these figures, as significant as they are, understate the full effect of lower airfares at BWI on airfares in the Washington-Baltimore community.

The experience at BWI demonstrates how a commitment on the part of airport managers to meeting the needs of prospective entrants for facilities and services, combined with a set of “entry friendly” business practices, can produce substantial economic benefits for an airport, air travelers, and a region. Airline competition at BWI is vigorous. And given the business practices in place at BWI, it is likely to remain so.

Airline deregulation presents opportunities for airport managers to modify their existing practices to maximize the price and service

⁵ United States General Accounting Office, *Airline Deregulation: Changes in Airfares, Service Quality, and Barriers to Entry*, February 1999, p. 41.

benefits of the deregulated airline marketplace. Some airport business practices, such as entering into long-term, exclusive use gate lease agreements, were once considered essential to securing a long-term financial commitment from tenant air carriers, which reduced perceived risk for investors and lowered the cost of capital for airports. Following the bankruptcies of several large air carriers in the 1980s and early 1990s, however, airport managers and the financial community recognized that these long-term contractual relationships were no assurance that tenant carriers would not fail and that airports would not see a significant deterioration in their financial condition if they did. According to many airport managers and financial professionals, investors in airport debt are, today, more concerned with the “economic fundamentals” of the airport issuing the debt (e.g., the strength of the local economy and traffic base) and less concerned with whether it has entered into a long-term, exclusive use, gate-lease agreement with one or more air carriers.

Some State and local officials are questioning whether current airport practices serve to reinforce the market power of established air carriers, especially at concentrated hub airports. In order to make it easier for air carriers to begin serving their communities, State and local officials are critically reviewing airport practices.

The Mayor of Charlotte, North Carolina, for example, has appointed a task force to study the issue of airline competition and airfares at Charlotte. Business leaders in Atlanta have been concerned with the level of airfares on many routes from Hartsfield. Because of the inability to expand capacity at Hartsfield in the short run, local officials are focusing their efforts on ways to improve the utilization of existing facilities. Last September a consultant was hired to study gate-utilization practices at Hartsfield, especially the gates that are leased to air carriers until 2010; the consultant will also review the utilization of ticket counter facilities. Better utilization of gates and other facilities at Hartsfield may offer a way to expand “effective” capacity, thereby making it more accessible to new entrants and allowing smaller incumbent carriers to grow. We have also been invited to Burlington, Vermont, to discuss how to make its airport more competitive.

Following the September 1998 strike at Northwest, public officials in Minnesota began to focus on ways to increase competition in their community. To hear the views of the public, Congressional representatives, airport officials, DOT staff, and local leaders participated in a meeting to discuss airline competition issues. Airport officials were quick to point out that access to airport facilities was not adversely affecting the ability of new entrants to

enter Minneapolis-St. Paul International Airport. Since then, however, airport officials, the airport commission, and the State of Minnesota have begun to examine all aspects of airline competition in their community, including the critically important role of competitive access to airport facilities. Among the policies being advanced to ensure competitive access for new entrants at MSP: (1) reserving a major share of any new gates built (12 are scheduled to be built) for carriers other than Northwest; (2) limiting the number of long-term, gate-lease agreements at MSP; (3) restricting the number of gates an incumbent carrier could control under long-term lease; and (4) reviewing all sublease agreements to ensure that air carriers are not unfairly disadvantaged.⁶

Competitive conditions will soon change at MSP. A charter operator, Sun Country, intends to offer low-fare, scheduled service from Minneapolis to a number of cities now served by Northwest. Sun Country's operations, if successful, could generate substantial consumer benefits. To mount a successful competitive challenge, however, Sun Country requires gates and other facilities, not only to begin providing service but also to expand if it attracts customers. Recently, after months of tough negotiations, Sun

⁶ Minnesota Planning, *Flight Plan, Airline Competition in Minnesota, St. Paul, Minnesota, March 1999*, pp. 19-20.

Country and the Metropolitan Airports Commission reached an agreement.⁷

The problems air carriers have had starting operations at Minneapolis and at other airports, our meetings with airport officials, and our review of the comments submitted to DOT, have sharpened our understanding of which business practices promote airline competition and which do not. Some airports combine elements – often several elements – of what I’ll call “best practices.” I would like to suggest that the following practices could promote competition at your airport.

Work with new entrants: As a matter of policy, most airports periodically make overtures to air carriers not serving their airports to entice them to do so – especially Southwest Airlines. But some airport managers do not make a real effort to encourage competitive entry at their airports. Some airport managers are more interested in “filling in” their existing service pattern than they are in encouraging new entry, and others claim that anything they could do to encourage entry is, at best, secondary in importance to other economic factors that influence entry.

⁷ “Sun Country Airlines to Sign Landmark Agreement to be Anchor Tenant at New Terminal, After Months of Intense Negotiations,” *Minneapolis Star-Tribune*, April 6, 1999.

We know that competitive entry at an airport can reduce fares, stimulate traffic, and result in economic growth for the community. And we all know that the ability of an air carrier to enter a market and compete successfully against one or more incumbent airlines depends on numerous economic and competitive factors. But one of these factors is certainly the ability of a prospective entrant to gain timely access on reasonable terms to gates and other facilities and services. Airport managers that are interested in promoting competition are actively seeking, even promoting, airlines to provide competitive service; they are working closely with new carriers during the startup period, including interceding on their behalf with incumbent carriers.

Gate utilization: Many of the airport officials we talked with had a detailed knowledge of gate utilization levels at their airports. But other officials had, at best, an imperfect understanding of how gates and other facilities were being used at their airports. Managing an airport's facilities to ensure that all gates and other facilities are used fully can be critical to being able to make gates and other facilities available to prospective entrants. Airport managers interested in promoting airline competition are closely monitoring gate-utilization practices.

Use-it-or-lose-it authority: Airport managers are often reluctant to invoke their authority under their existing contractual arrangements with tenant airlines to reallocate gates if they are not being used to maximum capacity. This is unfortunate. The ability to reallocate underutilized gates could be a powerful tool for promoting new entry. As airports renegotiate their gate lease agreements with incumbent carriers and, increasingly, opt to adopt preferential use leases, tenant air carriers should understand that if they are not using a gate to its maximum capacity, then, it may be assigned to another air carrier. **Airport managers that are interested in providing competitive access are willing to invoke use-it-or-lose-it authority if tenant carriers are not using their gates fully.**

Guidelines for entry: Some airport officials are reluctant to challenge the views of incumbent air carriers as to whether new entry can be accommodated. Not surprisingly, incumbent carriers almost always determine that new entry – and the increased competition that accompanies it -- is neither feasible nor desirable. Incumbent carriers at a heavily used airport may be in a position to make it difficult for a new entrant to begin operating, even if underutilized gates are available.

At some airports, prospective entrants are told to arrange with incumbent carriers for the use of airport facilities – a negotiating process that does not have a specific time limit, and which can be used by incumbents to delay entry for several months or, if successful, block it entirely. The longer it takes to begin operating at an airport the greater the costs the prospective entrant incurs (both in terms of direct expenditures and forgone passenger revenues). And because the entrant cannot be sure when it will begin operating, it encounters additional problems in marketing its services to travel agents and consumers.

Airport officials, not tenant airlines, should decide when an air carrier can begin operating from an airport. Airport managers that want to encourage competition provide entrants with clear guidelines as to what they must do to gain access to the airport and when they will be able to begin operations; they also explain how carriers can gain additional facilities as needed.

Sublease agreements: Officials at many of the nation's airports monitor sublease agreements between airlines to ensure they do not unfairly disadvantage one carrier. Of course, if an airport has substantial underutilized capacity, a new entrant would be able to enter into a competitive sublease agreement with one or more

incumbent carriers, even if it were not able to lease a gate directly from the airport authority. Airport officials interested in preserving competition at heavily used airports monitor sublease agreements and disapprove any agreement that places the sublessee at a competitive disadvantage.

Competitive services: Some airports, such as Orlando International, “will not consent to a sublease that requires the sublessee to obtain ground handling or other services on an exclusive basis from the Signatory Airline that is subleasing the space. This assures that the Fixed Based Operators at OIA [Orlando International Airport] are not precluded from competing for these services ... Competition between the Signatory Airlines and the Fixed Based Operators has assured that ancillary services are available to all airlines at reasonable prices at OIA.”⁸

Airport managers interested in promoting competition are creating a pro-business environment with competitive ground-handling and support services for all air carriers.

⁸ Comments of Egerton K. van den Berg, Executive Director, Greater Orlando Aviation Authority; U.S. Department of Transportation, Public Docket No. OST-98-4025, December 18, 1998, pp. 6-7.

Common use facilities: Common use gates and facilities serve to promote entry.⁹ Airport officials have recovered gates from air carriers or converted gates from exclusive use status to preferential or common use status because such policies increase the likelihood of successful entry. **Airport managers interested in promoting new air service are recovering gates when they become available and are converting gates and other facilities to common use status.**

Majority-in-interest clauses: Majority-in-interest clauses continue to play an important role in shaping competitive opportunities at airports. Of course, it is not hard to understand the logic behind MIs: Airlines that are assessed rates and charges to pay for capital projects believe they should be able to review and approve or disapprove such projects before they are undertaken. But many airports are also reviewing their majority-in-interest agreements to reduce the ability of incumbent airlines to prevent or delay projects that would promote new entry. **Airport officials that want to foster competition are making sure that any newly negotiated MIs cannot be used by incumbent air carriers to restrict projects that would promote new entry or competition among existing carriers.**

⁹ Airport control or common use arrangements, such as 30-day agreements or permit arrangements, occur when facilities remain under airport use or control. The airport is able to assign the facility on a temporary or per-use basis or on a short-term basis.

Passenger Facility Charges: Our forthcoming report will have a great deal to say about how Passenger Facility Charges have been used and what role they have played in promoting airline competition. Not only are PFCs a major source of funds for capital development projects, but they are an independent source of funds for airport managers – they can be imposed without first receiving the approval of tenant airlines. Also, of course, a PFC-financed project may not result in an airline obtaining a long-term “lock” on the facility; consequently, airport managers are adopting practices and conditions that promote entry and competition (e.g., use-it-or-lose-it provisions, non-exclusive use of facilities, subleasing approval and standards).

The Administration’s FAA reauthorization proposal would raise the current \$3 cap to \$5; to receive the fifth dollar, large airports served by a “dominant” carrier would have to submit to DOT a plan on how they intend to promote airport access, entry, and competition.

Airport managers interested in creating a competitive environment are using PFCs as a tool for promoting airline competition.

In conclusion, 1999 promises a most eventful year in terms of aviation issues, especially airline competitive issues. At DOT, we

believe that a competitive airline marketplace is the best way to ensure that all parties – passengers, air carriers, airports, and communities – continue to enjoy the benefits that are a result of airline deregulation.

Thank you.